

STATE OF NEW YORK
STATE TAX COMMISSION

In the Matter of Petition :
 of :
WARNER COMMUNICATIONS, INC. :
(Successor to Kinney Services, Inc.) :
for redetermination of deficiency of :
franchise tax under Article 9-A of :
the tax law for the fiscal year :
ended 9/30/69, :

Kinney Services, Inc. having filed a petition for re-determination of deficiency of franchise tax under Article 9-A of the tax law for the FYE 9/30/69, and a hearing having been held at the office of the State Tax Commission, 2 World Trade Center, New York City, at which hearing A. D. Youngwood, Esq. and M. M. Weinstein, Esq. of counsel appeared and the record having been duly examined and considered by the State Tax Commission,

It is hereby found:

(1) Kinney Services, Inc. ("Kinney") was incorporated in New York on 12/26/61 and was merged into Warner Communications, Inc. ("Warner"), a Delaware corporation, on 2/9/72.

(2) On 4/22/69, Kinney purchased, from an unrelated party, 15 shares (20% of the shares then outstanding) of the common stock of Warner Bros. - Seven Arts Records, Inc. ("Records"), for a total consideration of \$23,590,000. On 5/29/69, Kinney transferred the 15 shares to its wholly owned subsidiary, Independent News Co., Inc. ("Independent"), for a total consideration of \$20,790,000 (\$1,090,000 cash and \$19,700,000 accounts receivable), thus reflecting

a book loss of \$2,800,000. The selling price to Independent was based on the price originally paid by Kinney to the unrelated party, adjusted for dividends received during the interim period. Records had paid dividends of \$2,800,000 to Kinney during the period 4/22/69 to 5/29/69.

Kinney filed a consolidated return with its wholly owned subsidiaries for Federal purposes for the FYE 9/30/69. The book loss of \$2,800,000 had no effect on Federal taxable income since such loss was treated as a deferred intercompany transaction. Kinney filed an individual return for New York State franchise tax purposes and deducted the loss of \$2,800,000 in computing State taxable income for the FYE 9/30/69.

(3) On 1/27/70, Independent declared a dividend of the 15 shares of Records' stock, and the stock was returned to Kinney on 1/31/70. At that time Kinney made an entry on its books as follows:

DR: Investment in Records	\$22,292,000	
CR. Due from Independent		\$16,650,000
CR. Dividend Income		\$ 5,642,000

The above book credit to dividend income of \$5,642,000 had no effect for Federal purposes, since Kinney filed a consolidated Federal return for the FYE 9/30/70, and intercompany dividends are eliminated in computing Federal taxable income. Kinney filed an individual return for New York State franchise tax purposes, and eliminated such dividends in computing State taxable income for the FYE 9/30/70, as being dividends from subsidiary capital.

(4) The Corporation Tax Bureau disallowed the deduction for the loss of \$2,800,000 indicated at (2) and issued a statement of audit adjustment and notice of deficiency for the FYE 9/30/69 computed as follows:

Entire net income reported	(824,068.00)
Add deferred loss on sale of stock	2,800,000.00
Taxable net income	1,795,532.00
Tax at 7%	138,287.00
Subsidiary capital tax reported	17,285.00
Total	155,572.00
Tax per report	45,210.00
Deficiency	110,262.00

(5) Section 208.9(d) of the tax law reads as follows:

"The tax commission may, whenever necessary in order properly to reflect the entire net income of any taxpayer, determine the year or period in which any item of income or deduction shall be included, without regard to the method of accounting employed by the taxpayer;"

(6) Section 208.9(a)(1) of the tax law reads in part:

"(a) Entire net income shall not include:
"(1) income, gains and losses from subsidiary capital . . . "

The State Tax Commission hereby

DECIDES:

(A) The amount indicated in (2) was not a proper deduction to Kinney for the FYE 9/30/69, pursuant to Section 208.9(d) of the tax law. To give effect, for tax purposes, to a mere book entry showing a loss of \$2,800,000 would put form over substance and produce an improper tax result. The essence of the transaction was a temporary transfer of the stock to Independent, with the latter returning it to Kinney in the next fiscal year. On the return of the stock, Kinney made an entry on its books crediting dividend

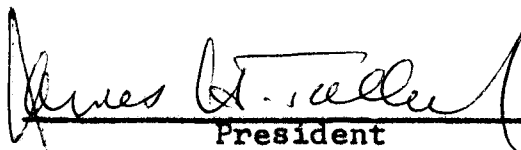
income of \$5,642,000 for the FYE 9/30/70. Such entry, however, had no effect on the franchise tax liability of Kinney, since such dividend income was eliminated from State taxable income pursuant to Section 208.9(a)(1).

(B) The deficiency set forth at (4) is affirmed, together with interest in accordance with Section 1084 of the tax law.

Dated: Albany, New York

this 14th Day of August 1975.

STATE TAX COMMISSION


President


Commissioner


Commissioner